

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended September 30, 2012



JOHN CHIANG
California State Controller

October 2013



JOHN CHIANG
California State Controller

October 30, 2013

California Lottery Commission
700 North Tenth Street
Sacramento, California 95811

Dear Commissioners:

The State Controller's Office analyzed the financial documentation supporting the California Lottery's (Lottery) transfer of funds to the public education community for the quarter ended September 30, 2012.

Our analysis found that the transfer amount of \$292,877,032 appears to be supported by the Lottery's accounting records, and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/sk

cc: Phil Tagami, Commissioner
California Lottery Commission
Nathaniel Kirtman III, Commissioner
California Lottery Commission
John Smolin, Commissioner
California Lottery Commission
Connie M. Perez, Commissioner
California Lottery Commission
Gregory Ahern, Commissioner
California Lottery Commission
Paula D. LaBrie, Acting Director
California Lottery
Nicholas Buchen, Deputy Director, Finance
California Lottery
Roberto Zavala, Chief Internal Auditor
California Lottery

Contents

Report of Analysis

Summary	1
Introduction	1
Background	1
Objectives, Scope, and Methodology	2
Results.....	2
Schedule 1—Summary of Lottery Transfers and Status of Compliance with Statutory Requirements	3
Attachment—California Lottery’s Transfer Request of November 19, 2012	

Report of Analysis

Summary

In a letter dated November 19, 2012, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$292,877,032 to the Lottery Education Fund for disbursement to the public education community. Our analysis found that the transfer amount appears to be supported by the Lottery's accounting records and the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

On December 28, 2012, the SCO transferred \$292,877,032 to the Lottery Education Fund. This amount includes \$4,715,142 withheld from the prior fiscal year-end, pending the financial statement audit and resolution of accounting issues. Due to the SCO's apportionment process, all funds except \$5.22 were disbursed to the public education community. This balance will remain in the Lottery Education Fund to be apportioned during the next quarterly transfer.

Introduction

This report presents the results of our analysis of the Lottery's quarterly request that the SCO transfer funds to the public education community. This analysis is part of our responsibility under the California State Lottery Act (Lottery Act). We performed this analysis to determine if the transfer of funds to the public education community was supported by amounts recorded in the Lottery's accounting records and to determine if the Lottery is on target to comply with the annual Lottery Education Fund allocation requirements contained in the Lottery Act.

Background

In 1984, California voters passed an initiative, which, by amending the State Constitution, authorized a state-operated lottery. The initiative created the Lottery Act, which requires the quarterly transfer of net revenues to the public education community and established the allocation percentages for lottery funds. The Lottery Act also requires the SCO to conduct quarterly and annual post-audits of all accounts and transactions of the California Lottery Commission and other special post-audits as the State Controller deems necessary.

The Lottery Act was amended by Assembly Bill 142 on April 8, 2010. The bill was an urgency statute that went into effect immediately. Assembly Bill 142 requires revenues from the Lottery to be allocated to maximize the amount of funding allocated to public education. The bill requires that not less than 87% of the total annual revenues from Lottery ticket sales be returned to the public in the form of prizes and funds to education and not more than 13% be allocated for Lottery expenses. The bill specified that not less than 50% of the total annual Lottery revenues, in an amount to be determined by the Lottery Commission, be returned to the public in the form of prizes. In addition, the bill requires the Lottery Commission to establish the percentages to be allocated to the benefit of public education.

Each quarter, the Lottery requests that the SCO transfer net revenues to the public education community (see Attachment). The Lottery's request usually occurs eight to ten weeks after the close of the quarter.

Objectives, Scope, and Methodology

We performed this analysis of the quarterly transfer of funds to public education in order to determine if:

- The Lottery's requested transfer amount of \$292,877,032, for the quarter ended September 30, 2012, is supported by accounting records; and
- The Lottery is on target to comply with the annual allocation requirements specified in the Lottery Act.

As part of our analysis, we traced the transfer amount to Lottery financial statements and accounting records and applied analytical review procedures to the lottery fund accounts by comparing them with those from the prior year.

Results

On December 28, 2012, the SCO transferred \$292,877,032 to the Lottery Education Fund. This amount includes \$4,715,142 withheld from the prior fiscal year-end pending the financial statement audit and resolution of accounting issues. Due to the SCO's apportionment process, all funds except \$5.22 were disbursed to the public education community. This balance will remain in the Lottery Education Fund to be apportioned during the next quarterly transfer.

After analyzing the Lottery's unaudited financial statements and supporting records for the quarter ended September 30, 2012, we determined that the Lottery's request to transfer \$292,877,032 to the Lottery Education Fund appears to be supported by formal accounting records.

For the quarter ended September 30, 2012, of the total revenues from ticket sales:

- 60.65% was returned to the public in the form of prizes;
- 27.53% was transferred to the public education community; and
- 11.82% was used for administrative expenses.

The Lottery returned 88.18% of the total revenues from the sales of tickets to the public in the form of prizes and funds to education. The Lottery appears to be on target to comply with the annual revenue allocation requirements specified in the Lottery Act. See Schedule 1 for a summary of Lottery transfers and allocation percentages.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

October 30, 2013

Schedule 1— Summary of Lottery Transfers and Allocation Percentages

Fiscal Year 2012-13	Quarter Ended ¹					
	09/30/2012	%	12/31/2012	%	03/31/2013	%
Sales	\$ 1,008,382,162	100.00%	\$	%	\$	%
Prizes	\$ 611,579,884	60.65%	\$	%	\$	%
Administration	\$ 119,232,009	11.82%	\$	%	\$	%
Available for Education	\$ 277,570,269	27.53%	\$	%	\$	%
Prizes and Available for Education	\$ 889,150,153	88.18%				
Other Income ²	10,591,621					
Adjustment	4,715,142 ⁴					
Transfer to Education	\$ 292,877,032		\$		\$	

Fiscal Year 2011-12	Quarter Ended ¹					
	09/30/2011	%	12/31/2011	%	03/31/2012	%
Sales	\$ 869,113,412	100.00%	\$ 1,971,252,588	100.00%	\$ 3,330,793,946	100.00%
Prizes	\$ 494,773,562	56.93%	\$ 1,146,667,271	58.17%	\$ 1,936,723,462	58.15%
Administration	\$ 105,050,044	12.09%	\$ 224,397,328	11.38%	\$ 374,310,153	11.24%
Available for Education	\$ 269,289,806	30.98%	\$ 600,187,989	30.45%	\$ 1,019,760,331	30.61%
Prizes and Available for Education	764,063,368	87.91%	1,746,855,260	88.62%	2,956,483,793	88.76%
Other Income ²	7,960,834		12,916,600		17,251,082	
Adjustment	4,999,206 ³		—		—	
Transfer to Education	\$ 282,249,846		\$ 613,104,589		\$ 1,037,011,413	

Annual Statutory Requirements Before AB 142

Prizes = Approximately 50% of sales
Administration = No more than 16% of sales
Available for education = At least 34% of sales
Other income = 100% due education

Annual Statutory Requirements After AB 142 (enacted April 8, 2010)

Prizes = Not less than 50% of sales
Administration = No more than 13% of sales
Prizes and available for education = Not less than 87% of sales
Other income = 100% due education

Note: The actual percentage allocation is computed on an annual basis when determining whether the Lottery has met the allocation requirements. The percentages shown above indicate the Lottery's year-to-date progress toward meeting these requirements.

¹ Quarterly amounts represent fiscal year-to-date totals.

² Includes interest income, other income, and unclaimed prizes.

³ This represents the amount withheld in the fourth quarter of FY 2009-10, pending the financial audit and resolution of accounting issues.

⁴ This represents the amount withheld in FY 2011-12, pending the financial audit and resolution of accounting issues.

**Attachment—
California Lottery's
Transfer Request of November 19, 2012**



November 19, 2012

Mr. George Lolas, Chief
Division of Accounting and Reporting
State Controller's Office
3301 C Street, Suite 700
Sacramento, CA 95816

Dear Mr. Lolas:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$292,877,032. This figure represents:

Operating income for the three months ended	
September 30, 2012	\$ 277,570,269
SMIF interest earned	358,019
Other income	15,447
Unclaimed prizes	<u>10,218,155</u>
	<u>\$ 288,161,890</u>
Amount withheld from 2011-2012 fiscal year	
pending audit	\$ 4,715,142
	<u><u>\$ 292,877,032</u></u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Assets for the three months ended September 30, 2012, prepared from books without audit, for your files.

Sincerely,


Meggie Chan, Acting Deputy Director
Finance Division

Attachment
cc: Robert O'Neill, Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Assets
For the Three Months Ending September 30, 2012

Lottery sales	\$1,008,382,162
Prizes	611,579,884

Sales after prizes	\$396,802,278

Less game costs:	
Retailer costs	\$69,542,333
On-line game costs	10,907,255
Off-line game costs	8,075,790

Total game costs	\$88,525,378

Income before operating expenses	\$308,276,900

Operating expenses:	
Salaries, wages and benefits	\$11,649,259
Advertising	9,823,228
Promotion, public relations and point of sale	991,732
Other professional services	3,424,169
Depreciation and amortization	1,529,189
Other general and administrative expenses	3,289,054

Total operating expenses	\$30,706,631

Operating income	\$277,570,269
Non-operating (expenses) revenues:	
Investment earnings	\$384,879
Other Income	15,447
Allocation to Education Fund	(277,943,735)

Total non-operating (expenses) revenues	(\$277,543,409)
Changes in net assets	\$26,860
Total net assets-beginning of year	155,597,555

Total net assets-end of year	\$155,624,415
	=====

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>